

SUMMARY ANALYSIS OF AMENDED BILL

Author: Committee On Budget Analyst: Gail Hall Bill Number: AB 1452
 Related Bills: See Prior Analysis Telephone 845-6111 Amended Date: September 15, 2008
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Suspend NOLs 2008 & 2009/Allow 20-year Carryover Starting 2008/Tax Amnesty
 2009/Create LLC Estimated Payment/50% Limitation on Business
 Credits/Assignment of CTL Credits Among Members

- ☒ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended August 29, 2008.
- ☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- _____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- _____ FURTHER AMENDMENTS NECESSARY.
- _____ DEPARTMENT POSITION CHANGED TO _____.
- _____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.
- ☒ OTHER – See comments below.

SUMMARY

This bill would do the following:

Provision No. 1: Suspend net operating loss (NOL) deductions for 2 years, make the NOL carryover period 20 years, and allow taxpayers a 2-year carryback for NOLs beginning 2011.

Provision No. 2: Authorize Franchise Tax Board (FTB) to conduct a tax amnesty for the 2003 through 2006 tax years for corporation and personal income taxpayers.

Provision No. 3: Require a limited liability company (LLC) to estimate and pay its LLC fee by a specific date of the taxable year.

Provision No. 4: Limit the amount of tax credits that may reduce tax for 2 years, and allow tax credits to be assigned among members of a combined reporting group under the Corporation Tax Law (CTL).

Board Position:

_____ S _____ NA _____ NP
 _____ SA _____ O _____ NAR
 _____ N _____ OUA ☒ PENDING

Legislative Director

Date

Patrice Gau-Johnson for
 Brian Putler

9/29/08

SUMMARY OF AMENDMENTS

The September 15, 2008, amendments made the following changes:

- Revised the operative date language for the 20-year NOL carryover provision from taxable years beginning on or after January 1, 2010, to taxable years beginning on or after January 1, 2008.
- Added a 2-year carryback provision for NOLs.
- Added a provision that taxpayers with income under certain thresholds were exempt from the NOL suspension provisions.
- Resolved the technical considerations discussed in the analysis of the bill as amended September 15, 2008.
- Added a requirement that an LLC must estimate and pay its LLC fee by a specified date.
- Added a 50% limitation on the usage of tax credits for 2 years, but added that taxpayers with income under a certain threshold were exempt for the limitation.
- Added a provision allowing tax credits to be assigned among members of a combined group.

Except for the changes discussed above, the analysis of the bill as amended August 29, 2008, still applies, but has been discussed again below, except for the “Other States” and “Legislative History” discussions, for convenience.

PURPOSE OF THE BILL

The purpose of this bill is to accelerate receipt of tax revenues, allow the sharing of tax credits among certain affiliates of a unitary group of taxpayers, and conform to the federal NOL carryback rules with modifications.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would go into immediate effect. The operative dates of these changes vary and will be addressed separately for each provision.

ECONOMIC IMPACT - SUMMARY REVENUE TABLE

Revenue Impact of AB 1452 Suspension of NOL Deductions/NOL 20-Year Carryover/Amnesty/50% Limitation on Business Credits/Assignment of Business Credits Among Members Enactment Assumed before January 1, 2009				
	2007-08	2008-09	2009-10	2010-11
NOLs				
20-Year Carryover	No Revenue Impact Until 2021 (See discussion)			
NOL Suspension	-0-	+\$1.090 Billion	+\$600 Million	-\$280 Million
NOL Carrybacks	-0-	-0-	-0-	-\$ 40 Million
Amnesty 2009	+\$469 Million	– \$110 Million	–\$ 95 Million	–\$200 Million
LLC Estimate Payments	-0-	+\$360 Million	+\$ 35 Million	+\$40 Million
Limit On Tax Credits	-0-	+\$630 Million	+\$380 Million	–\$ 55 Million
Allow Credits to be Assigned	-0-	-0-	-\$110 Million	–\$330 Million
Allow NOLs and Credits if Business Income Less than \$500,000	-0-	–\$240Million	-\$140 Million	+\$ 20 Million
Interaction Between NOL and Credit Provisions	-0-	+\$275 Million	+\$195 Million	+\$495 Million
Totals	+\$ 469 Million	+\$2.005 Billion	+\$865 Million	–\$350 Million

POSITION

Pending.

PROVISION NO. 1: SUSPEND NOLS/EXTEND NOL CARRYOVER PERIOD/ALLOW CARRYBACKS

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this provision would be effective immediately upon enactment and would be specifically operative as follows:

1. Suspension of NOLs: operative for taxable years beginning on or after January 1, 2008, and before January 1, 2010.
2. Extension of NOL carryover period to 20 years: operative for NOLs attributable to taxable years beginning on or after January 1, 2008.
3. Allowance of a NOL carryback: operative for NOLs attributable to taxable years beginning on or after January 1, 2011.

ANALYSIS

FEDERAL LAW

When a taxpayer has an operating loss for the taxable year, the operating loss that may be used in subsequent years is called a net operating loss (NOL). An operating loss occurs when a taxpayer's allowed deductions in connection with conducting a trade or business exceed its gross income for that year. Federal law provides, in general, that an NOL can be carried back 2 years and forward 20 years and deducted. Special rules are provided for the carryback of NOLs relating to issues such as specified liability losses, casualty or theft losses, disaster losses of a small business, and farming losses.

In general, a California taxpayer calculates its NOL in accordance with federal rules. Two important differences are that California does not allow the carryback of NOLs and limits the carryforward period to 10 years in circumstances where federal law allows 20 years. Depending on the type of taxpayer or amount of a taxpayer's income, the amount of NOL that is eligible to be carried forward and the number of years it can be carried forward will vary.

STATE LAW

The taxpayer must make an election from the following list as to the type of NOL the taxpayer has incurred.

Existing state law provides for the following types of NOLs:

Type of NOL and Description	NOL % Allowed To Be Carried Over	Carryover Period (Current State Law)
General NOL	100%	10 Years
New Business NOL	100%	10 Years
Eligible Small Business	100%	10 Years
Pierce's Disease	100%	9 Years
Economic Development Areas	100%	15 Years

THIS PROVISION

This provision applies to both the Personal Income Tax Law (PITL) and the CTL, and would make the following changes:

- Disallow NOL deductions by suspending them for taxable years 2008 and 2009 for a taxpayer with net business income (PITL) and income subject to tax (CTL) of \$500,000 or more. However, deductions for NOL carrybacks from taxable years beginning on or after January 1, 2011, would be allowed.
 - For PIT, “net business income” means income from a trade or business, whether conducted by the taxpayer or by a pass-through entity (partnership or S corporation), income from rental activity, and income attributable to a farming business.
- Extend the NOL carryover period by one year for NOLs incurred in taxable year 2008, and two years for NOLs attributable to taxable years beginning before January 1, 2008.
- Allow a 20-year NOL carryover period for NOLs attributable to taxable years beginning on or after January 1, 2008.
- Conform to the federal NOL carryback rules for NOLs attributable to taxable years beginning on or after January 1, 2011, with the following modifications:
 - Allow an NOL to be carried back only 2 years. (Federal law has special rules that in some cases, allow an NOL to be carried back for a longer period).
 - Limit the amount of NOL carryback attributable to taxable year 2011 to 50% of the net operating loss.
 - Limit the amount of NOL carryback attributable to taxable year 2012 to 75% of the net operating loss.
 - Conform to the federal carryback period for a Real Estate Investment Trusts (REITS) and a corporate equity reduction interest loss, which is zero.

FISCAL IMPACT

This provision would not significantly impact the department’s costs.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of the NOL provisions, under the assumptions discussed below, is estimated to be as follows:

Estimated Revenue Impact of This Provision (NOLs) ¹ Enactment Assumed before January 1, 2009			
	2008-09	2009-10	2010-11
20-Year Carryover	No Revenue Impact Until 2021 (See discussion)		
NOL Suspension	+\$1.09 Billion	+\$600 Million	–\$280 Million
NOL Carryback	-0-	-0-	–\$ 40 Million

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision.

20-Year Carryforward

Because current state law allows 100% of unused NOLs to be carried forward for ten years, this provision would have no revenue impact for the first ten years. The first revenue impact of this bill would be in the eleventh year: 2020. Using company-level data and a micro-simulation model, it was estimated that \$400 million of corporation and \$80 million PIT NOLs generated in 2008 would now, under this provision, be carried forward to the eleventh year and would be used in 2021. Using an average tax rate of 5.3%, this would result in a combined revenue loss of approximately \$25 million in 2020 $[(\$400 \text{ million} + \$80 \text{ million}) \times .053 \approx \$25 \text{ million}]$.

The amounts of NOL carryforwards would increase in subsequent years as losses generated in 2010 and beyond are incurred. Taking into account the losses generated after 2009, the sum of all the losses carried forward to 2030 would reach \$2 billion for corporations and \$400 million for the PIT taxpayers. At an average tax rate of 5.3%, this would result in a revenue loss of approximately \$127 million in that year $[(\$2 \text{ billion} + \$400 \text{ million}) \times .053 \approx \$127 \text{ million}]$.

Suspend NOLs for 2008 and 2009

The revenue impact of suspending the NOL deduction for taxable years 2008 and 2009 was estimated using company-level data and a micro-simulation model. For 2008, NOL deductions were projected to be \$14 billion for corporation taxpayers and \$3 billion for the PIT taxpayers. Using an average tax rate of 5.3%, disallowing NOL deductions would result in a revenue gain of approximately \$900 million for the 2008 tax year $[(\$14 \text{ billion} + 3 \text{ billion}) \times .053 \approx \$900 \text{ million}]$. The numbers in the table above have been adjusted to reflect revenue estimates for fiscal years.

¹ There is an interactive effect between the revenue estimates for the NOL provisions and the business credit limitation/assignment provisions, which is shown in the summary table on page 2. There is also a combined revenue estimate for allowing NOLs and business credits for business with income less than \$500,000, which is also shown on the summary revenue table on page 2.

2-Year NOL Carryback

The 2-year NOL carryback provisions are operative for NOLs attributable to taxable years beginning on or after January 1, 2011. The revenue impact was estimated using company-level data and a micro-simulation model. The amount of carrybacks in 2011 were projected to be \$3.5 billion for corporations and \$700 million for personal income taxpayers. Assuming a tax rate of 5.3%, the carryback provisions would result in a projected tax revenue loss of approximately \$220 million for carrybacks in 2011. After adjusting the estimate to reflect fiscal years, the estimated revenue loss for fiscal years 2010-11, 2011-12, and 2012-13 would be \$40 million, \$480 million, and \$430 million respectively.

PROVISION NO. 2: AMNESTY 2009

EFFECTIVE/OPERATIVE DATE

As an urgency statute, the amnesty provision of this bill would be effective and operative immediately upon enactment, with the tax amnesty itself to be specifically conducted during the period beginning on February 1, 2009, and ending March 27, 2009, for taxable years 2003 through 2006.

ANALYSIS

FEDERAL LAW

Federal law does not provide for a comparable amnesty program.

STATE LAW

Under the state PITL or CTL, numerous penalties may be imposed against individuals and corporate taxpayers that fail to report or underreport income. Additionally, certain penalties are imposed against third parties that assist taxpayers in the nonreporting or underreporting of income. Certain fees are imposed against taxpayers that fail to file returns or pay their tax liabilities.

Taxpayers that fail to report or underreport their income may be subject to criminal prosecution and sanctions. Depending upon the gravity of the offense, such taxpayers may be guilty of either a misdemeanor or felony. Upon conviction, such taxpayers are subject to fines or imprisonment or both, together with costs of investigation and prosecution.

When a taxpayer fails to file an income tax return, there is no statute of limitations for enforcing the filing requirement. If a taxpayer fails to report or underreport income, FTB has the authority to estimate the net income of that taxpayer from any available information. When the tax liability is determined based on the estimate of net income, FTB may issue a notice of proposed deficiency assessment (NPA) for the additional tax, penalties, and interest.

THIS PROVISION

This provision would authorize FTB to conduct a tax amnesty for taxpayers subject to PITL and CTL that would provide an opportunity for eligible taxpayers to receive a penalty or fee waiver for unpaid penalty and fee amounts assessed on the 2003 through 2006 taxable years. FTB would accept applications for amnesty starting February 1, 2009, and ending March 27, 2009, with all returns and payments required to be filed and made by June 1, 2009.

The following taxpayers would not be eligible to participate in tax amnesty under this bill:

- Taxpayers who have had criminal complaints filed against them.
- Taxpayers who are under criminal investigation.
- Taxpayers with non-reported or underreported tax liability amounts attributable to a potentially abusive tax avoidance transaction, as defined.

Eligible taxpayers would be required to file a completed tax amnesty application within the amnesty filing period electing to participate in the tax amnesty and by June 1, 2009, do all of the following (as applicable):

- File a complete original tax return for any taxable year eligible for amnesty for which the taxpayer has not filed a return.
- File an amended return for any taxable year eligible for amnesty where the taxpayer underreported income on the original tax return.
- Pay in full any taxes and interest due for each taxable year for which amnesty is requested or apply for an installment payment agreement.
- Pay in full any tax and interest amounts previously proposed to be assessed.

Taxpayers that are under the jurisdiction of a federal bankruptcy court would be authorized to participate in tax amnesty if they submit an order from a federal bankruptcy court that allows them to participate.

Taxpayers currently in an installment payment agreement would be exempt from the amnesty penalty on those amounts covered by the existing installment payment agreement if they choose not to participate in tax amnesty, but could elect to participate in amnesty to waive any unpaid penalty or fees. If such a taxpayer elected to participate in tax amnesty, the provision exempting them from the amnesty penalty would no longer apply.

Taxpayers that enter into an installment payment agreement under tax amnesty would be given until June 30, 2010, to pay any amount of tax and interest in full. If a taxpayer failed to meet this requirement, the amount of any penalties and fees waived would be restored, unless FTB determined the failure was due to reasonable cause and not willful neglect. The total amount of tax, penalty, fee, and interest would also become immediately due and payable if such a failure to pay in full occurred.

This provision would authorize FTB to prescribe the form of the tax amnesty application and would require FTB to conduct an education and outreach effort to inform as many eligible taxpayers as possible through a streamlined process. The provisions would authorize FTB to issue forms, instructions, notices, rules, or guidelines to implement the tax amnesty and would provide an exception to the Administrative Procedures Act for this purpose.

The provisions would authorize, in addition to any other applicable penalty, an amnesty penalty to be added to the tax for amounts in each taxable year for which amnesty could have been requested that would be calculated as follows:

1. For amounts that are due and payable on the last day of the tax amnesty period, an amount equal to 50 percent of the accrued interest payable for the period beginning on the last date prescribed by law for the payment of that tax and ending on the last day of the tax amnesty period.
2. For amounts that are due and payable after the last day of the tax amnesty period, an amount equal to 50 percent of the interest computed for the period beginning on the last date prescribed by law for the payment of the tax for the year of the deficiency and ending on the last day of the tax amnesty period.

Tax deposits made before the end of the tax amnesty period would reduce the amount on which the amnesty penalty is computed. Any amounts attributable to the following types of assessments would not be subject to the amnesty penalty:

- An assessment resulting from an audit, where FTB first contacted the taxpayer in writing in connection with that assessment before March 27, 2009, if that assessment was not final before March 27, 2009; or
- An assessment resulting from the failure to file a return or the filing of a false or fraudulent return where FTB first contacted the taxpayer in writing in connection with that assessment before March 27, 2009, if that assessment was not final before March 27, 2009.

A refund or credit for any amounts paid to satisfy a penalty imposed under this section could be allowed only on grounds that the amount of the penalty was not properly computed. Additionally, no refunds would be allowed on amounts paid pursuant to tax amnesty.

The provisions would reiterate existing law regarding when amounts are due and payable.

Upon conclusion of the tax amnesty period, this bill would authorize FTB to do the following with respect to the difference between the amount shown on an original income tax return under tax amnesty and the correct amount of tax:

- Propose a deficiency upon any return filed,
- Impose penalties and fees, or
- Initiate criminal action against the taxpayer.

FISCAL IMPACT

Conducting a tax amnesty as required by this provision would require a significant effort by FTB to implement. FTB estimates it would need additional funding over three fiscal years to process the amnesty applications; make system changes and account adjustments; provide customer service support; and develop and conduct an education, outreach, and marketing plan for tax amnesty. Because of the magnitude of the effort this provision would require, FTB would need a budget augmentation in the current fiscal year, and in the next two fiscal years, to conduct a tax amnesty. FTB estimates a total cost of \$17.98 million, broken out by fiscal year as follows:

Tax Amnesty 2009	Cost	PYs²
Current year 08/09	\$8,000,000	45.2
Budget year 09/10	\$5,408,000	72.6
Budget year 10/11	\$4,572,000	59.8
Total	\$17,980,000	177.6

The Franchise Tax Board lacks sufficient resources to redirect \$17.98 million of estimated costs to administer Tax Amnesty without severely impacting the baseline revenue generating functions in its Audit, Collection, Filing Enforcement and Filing programs. If not funded specifically to administer Tax Amnesty, FTB would not implement the FY 08/09 BCPs.

Because Tax Amnesty would impact all aspects of FTB's operations and programs, redirection would impair both the department's existing revenue generating efforts, including critical tax return and cashiering functions, and the accelerated revenue anticipated from Tax Amnesty. The anticipated revenue loss attributable to redirecting funds from FTB's operating budget to cover Tax Amnesty costs would result in a loss of new revenues of approximately \$100 million. The loss of revenue would be estimated as follows:

Fiscal Year	BCP Funding Redirected	Revenue Impact
FY 08/09	\$9.1 million	\$40 million
FY 09/10	\$5.4 million	\$32 million
FY 10/11	\$4.6 million	\$27 million

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this provision would result in the following revenue gain in 2007-08 and losses starting in 2008-09, for a net revenue loss of about \$30 million.

Estimated Revenue Impact of Amnesty 2009				
Operative January 1, 2009				
(\$ in Millions)				
2007-08	2008-09	2009-10	2010-11	2011-12+
+\$469	-\$110	-\$95	-\$95	-\$200

² Personnel Years

This analysis does not account for changes in employment, personal income, or gross state produce that could result from this provision.

Revenue Discussion

The revenue impact of the provision would be dependent upon: (1) the number of taxpayers and business entities that participate and pay their outstanding amnesty-eligible tax and interest by March 27, 2009 (or by June 30, 2010 with an amnesty installment agreement), (2) the amount of fees, penalties, and interest on those penalties that are forgiven, and (3) the amount of post-amnesty penalties assessed and paid.

In the 2005 amnesty program, most of the revenue received came from tax deposits that were known as Protective Claims (PC). Taxpayers who believed that tax and interest might be owed in connection with ongoing or anticipated audits, protest, appeals or settlements made PC payments to avoid the new 50% interest-based penalty. Over half of PC payments received in 2005 were for the 1999 – 2003 tax years.

It is expected that fewer taxpayers would make tax deposits for a 2009 amnesty program, due to the slowing economy and to the penalty exception for current audits. It is assumed that tax deposits for tax years 2003 through 2006 would be \$377 million or 25% of the anticipated audit revenues of \$1.5 billion from audits with first written contact occurring after March 27, 2009.

It should be noted that of the \$3.5 billion PC payments from the 2005 amnesty, the Department of Finance and the Legislative Analyst Office estimated that only 5% or \$180 million was new revenue. Therefore, it is assumed that 95% of the \$377 million in tax deposit revenue is accelerated or will be refunded to the taxpayer in future years at the same rate at which 2005 PC are being resolved.

Based on the 2005 amnesty, it is assumed that of the delinquent PIT accounts and Business Entity accounts with one or more 2003 through 2006 tax liabilities will make accelerated payments of tax and interest due of \$462 million during the amnesty period of February 1, 2009 through June 31, 2010 (under installment agreements). After netting out the forgiven penalties, interest on those penalties, fees, refunded tax deposits, and post-amnesty penalties assessed in 2010-11 there will be a gain of \$469 million for fiscal year 2008-09 and losses of \$110 million for fiscal year 2009-10, \$95 million for 2010 –11 and 2011-12. All of these estimates are accrued back one year in the fiscal table.

PROVISION NO. 3: LLC ESTIMATE PAYMENTS

EFFECTIVE/OPERATIVE DATE

As part of an urgency statute, this provision would be effective immediately on the date of enactment and operative as of that date. If the bill is enacted before October 15, 2008, LLCs with a taxable year beginning on or after May 1, 2008, would be subject to the new requirement.

ANALYSIS

FEDERAL/STATE LAW

Federal law lacks provisions that require an LLC to pay an annual tax or fee.

Under current state law, an LLC not classified as a corporation must pay the \$800 annual LLC tax and the annual LLC fee if it is organized, doing business, or registered in California. The annual LLC fee is based on total income from all sources derived from or attributable to this state.

The LLC fee is due and payable on or before the 15th day of the 4th month following the close of the taxable year (e.g. April 15th for calendar year taxpayers), and is subject to underpayment penalties, late penalties, and interest.

THIS PROVISION

This provision would require an LLC to estimate and pay its LLC fee by the 15th day of the 6th month of the taxable year (e.g. June 15th for calendar year taxpayers).

In addition, this provision would impose a 10% penalty when an LLC underpays the estimated fee under certain circumstances. The underpayment penalty would not be imposed when the estimated fee payment for a taxable year is greater than or equal to the LLC's prior year fee liability.

FISCAL IMPACT

The department's costs to administer this bill are estimated at approximately \$290,000 in the first year and approximately \$72,000 in each year thereafter.

ECONOMIC IMPACT

Revenue Estimate

The revenue for this provision is as follows:

Estimated Revenue Impact of LLC Estimate Payments For Taxable Year BOA January 1, 2009 (\$ in Millions)				
Fiscal Year	2007-08	2008-09	2009-10	2010-11
LLC Fee Payment Due Date	-0-	+ \$360	+ \$35	+ \$40

Revenue Discussion

The revenue impact of this provision depends on the amount of LLC fees paid that would be accelerated into an earlier fiscal year. In 2005, LLC fees were \$285 million. Based on historical growth patterns and adjusting for the drop in revenue from the passage of AB 198, the amount of LLC fees will have grown to approximately \$370 million in 2009.

Based on taxpayer filing behavior, over 95% of LLCs file on a calendar year basis. It is estimated that the entire amount of 2009 LLC fees would be paid by the second estimated payment due in June. This would accelerate the LLC fee revenue from April, 2010, to June of 2009. The difference between current law and proposed law for 2008-09 is the \$360 million of 2009 LLC payments that would be accelerated from return payments to the second estimated payment of the current taxable year. In subsequent years, there would be continued net acceleration of revenue based on the growth in the amount of LLC fees.

PROVISION NO. 4: LIMIT TAX CREDITS/ALLOW CREDITS TO BE ASSIGNED TO OTHER MEMBERS

EFFECTIVE/OPERATIVE DATE

As an urgency statute, this provision would be effective immediately upon enactment and would be specifically operative as follows:

- 50% limitation on tax credits: operative for taxable years beginning on or after January 1, 2008, and before January 1, 2010.
- Assignment of tax credits between unitary members (CTL only): operative for taxable years beginning before, on or after July 1, 2008, for any eligible credit allowed to a taxpayer. In addition, an assigned credit may not reduce tax for a taxable year beginning before January 1, 2010.

ANALYSIS

FEDERAL/STATE LAW

Current federal and state laws do not permit the assignment of tax credits among taxpayers.

THIS PROVISION

Provisions of the bill regarding a limitation on the application of certain credits specifically apply to both the PIT law and the CTL and would make the following changes:

- Limit the amount of allowable “business credits” to an applicable amount (before application of any credits) for taxable years beginning on or after January 1, 2008, and before January 1, 2010.
 - Under PIT, “business credit” includes credits under a specific chapter of the PITL other than credits relating to household and dependent care, adoption costs, renters, personal exemption, joint custody head of household and for care of dependent parent, senior head of household, and excess contributions of unemployment compensation. This provision specifically provides that these excluded credits shall be required to be applied before any business credits.
 - Under PIT, “applicable amount” is equal to 50% of the net tax³ before the application of any credits.

³ Defined in Revenue & Taxation Code (R&TC) section 17039.

- Provide that any amount of the credit that may not be allowed due to the 50% limitation shall be a credit carryover under PITL and CTL, and the carryforward period shall be increased by the number of taxable years the credit was not allowed.
- This provision excludes taxpayers with net “business income” (PITL) and income subject to tax (CTL) of less than \$500,000.
 - Under PITL, “business income” means income from a trade or business (including partnerships and S corporations), rental activities, and a farming business.

The provision allowing the assignment of certain credits under the CTL applies to taxpayers under CTL that are members of a combined reporting group:

- Provides that an “eligible credit” may be assigned by a taxpayer to an “eligible assignee.”
 - “Eligible credit” means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, that is eligible to be carried forward to the taxpayer’s first taxable year beginning on or after July 1, 2008.
 - “Eligible assignee” means any “affiliated corporation” that is properly treated as a member of the same combined reporting group⁴ at specified times.
 - “Affiliated corporation” means a corporation that is a member of a commonly controlled group.⁵
- The election to assign any credit is irrevocable once made and is required to be made on the taxpayer’s original return for the taxable year in which the assignment is made.
- Gives the Franchise Tax Board (FTB) authority to issue rules, procedures, guidelines and regulations necessary to implement this provision.
- Requires FTB to issue a report on or before June 30, 2013, to the Joint Legislative Budget Committee, the Legislative Analyst, and the relevant policy committees.

FISCAL IMPACT

This provision would not significantly impact the department’s costs.

⁴ Pursuant to R&TC section 25101 or 25110.

⁵ R&TC section 25105.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of Business Credit Limitation/ Allow Business Credits to be Assigned ⁶ For Taxable Year BOA January 1, 2009 (\$ in Millions)				
Fiscal Year	2008-09	2009-10	2010-11	2011-12
50% Limitation On Credits	+ \$630	+ \$380	- \$ 55	-\$115
Assignment of Credits	-0-	- \$110	- \$ 330	-\$365

Revenue Discussion

Limitation on Use of Business Credits

The revenue gain from limiting all business credits is estimated in two steps. First, the revenue gain from corporation taxpayers is simulated based on a sample of corporate tax returns from the 2005 tax year. Their taxes are recomputed with the constraint that all business credits claimed must be less than 50% of taxes before credit. This constraint does not apply to small corporations, those with state net income below \$500,000. The revenue gain from limiting business credit use is the difference between the recomputed tax and actual tax. In the second step, this revenue gain is increased by 6% to account for PIT taxpayers. This percentage represents the proportion of R&D credits claimed by PIT taxpayers. The revenue gains for the 2005 tax year is extrapolated to 2008 and 2009 based on the Department of Finance's May 2008 forecast of corporate profits.

It should be noted that this estimate takes into account the interaction with suspending NOLs, since these two provisions are implemented at the same time. The amounts of suspended NOL and unused R&D credits from the 2008 and 2009 tax years are assumed to be used in the later years, resulting in revenue losses for the 2010 taxable year and later.

⁶There is an interactive effect between the revenue estimates for the NOL provisions and the business credit limitation/assignment provisions, which is shown in the summary table on page 2. There is also a combined revenue estimate for allowing NOLs and business credits for business with income less than \$500,000, which is also shown on the summary revenue table on page 2.

Assignment of Credit Between Members of a Unitary Group

The revenue loss from allowing members of a unitary group to share credits is simulated using the same 2005 sample of corporate tax returns, using corporations which are part of a unitary group and which paid more than the minimum tax. In this simulation, the tax of a corporation filing a combined return is recomputed with the assumption that unused R&D credits are allowed to be used until either its tax is reduced to the minimum tax, or the unused R&D credits are exhausted. The difference between the recomputed tax and actual tax is the revenue loss. This loss is raised by 25% to account for all other non-R&D business credits. The 2005 revenue loss is extrapolated to 2010 and later tax years based on DOF May 2008 forecast of corporate profit.

LEGISLATIVE STAFF CONTACT

Legislative Analyst
Gail Hall
(916) 845-6111
gail.hall@ftb.ca.gov

Revenue Manager
Rebecca Schlusser
(916) 845-5986
rebecca.schlusser@ftb.ca.gov

Legislative Director
Brian Putler
(916) 845-6333
brian.putler@ftb.ca.gov